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The System in 1987

HYDRO-QUÉBEC IN PROFILE

Hydro-Québec is a Crown corporation governed by the *Hydro-Québec Act*. It is a joint-stock company with the Québec government as its sole shareholder. Its principal mission is to generate, transmit and distribute electricity throughout Québec, but it also carries out research and promotion related to electricity, energy transformation and conservation and allied fields.

Hydro-Québec was created in 1944 through acquisition of Montreal Light, Heat and Power Consolidated and Beauharnois Light, Heat and Power Company, private companies that supplied the Montréal area with electricity. In 1963 it acquired most remaining private electricity companies and cooperatives in Québec and gradually established a vast, integrated electrical generating, transmission and distribution system for the whole of Québec.

Today Hydro-Québec supplies electricity to 2,947,413 customers in Québec, including 13,088 industries. It also exports some 29 billion kilowatthours to neighboring systems in Canada and the Northeastern United States. Its gross generation is 96.2% hydroelectric and its transmission system comprises over 33,000 circuit-kilometres of lines. With assets of $31.7 billion and an installed capacity of 24,533 megawatts Hydro-Québec ranks among the largest industrial corporations in Canada and largest electric utilities in North America.

Gouvernement du Québec
Office of the Minister of Energy and Resources

Québec City, March 9, 1988

Mr. Pierre Lorrain
President of the National Assembly
Québec City

Dear Sir,

I have the honor of presenting to you the annual report of Hydro-Québec for the year ended December 31, 1987.

Yours respectfully,

John Ciaccia
Minister of Energy and Resources

Five-Year Comparison in Figures

Financial indicators* *(Millions of dollars)*	**1987**	1986	1985	1984	1983
Total assets	**31,659**	30,588	29,183	27,129	25,179
Long-term debt	**21,198**	20,349	20,123	18,326	16,453
Shareholder's equity	**7,531**	7,023	6,720	6,511	6,366
Capital expenditures	**1,581**	1,470	1,528	1,591	2,170
Revenue from sales of electricity	**5,040**	4,673	4,423	4,101	3,593
Net income	**508**	303	209	301	707
Operating statistics					
Installed capacity** *(Megawatts)*	**24,533**	24,475	23,510	23,480	21,301
Sales of electricity *(Billions of kilowatthours)*	**152.9**	144.1	133.9	123.8	107.7
Total number of customer accounts *(Thousands)*	**2,947**	2,862	2,784	2,697	2,644
Number of permanent employees	**18,933**	18,470	18,208	18,560	18,975

* These indicators are taken from the consolidated financial statements, which contain the financial statements of Hydro-Québec and its subsidiaries.

** In addition to its own installed capacity, Hydro-Québec has access to most of the generation of the Churchill Falls power plant, which has a nominal capacity of 5,225 megawatts.

From raw material to finished product... electricity turns the wheels of industry.

Message From The Chairman Of The Board And The President And Chief Executive Officer

A. Hervé Hébert

Guy Coulombe

Hydro-Québec achieved encouraging results in 1987. Not only did it make major progress on Québec and export markets, it also succeeded in improving its principal financial ratios. Favorable economic conditions undoubtedly contributed, but the results also reflect the success of our continuing recovery measures, introduced several years ago, and the noteworthy collaboration of our entire personnel without whose dedication and competence the results would not have been possible.

Sales rise again

Reinforcing the position of electricity on the Québec market, especially in the industrial, commercial and institutional sectors where oil still occupies a large place, was a priority in 1987, as was accelerating sales on export markets.

At year-end, sales to industry showed a growth of 14.2%, reaffirming the interest of Québec firms in the special programs and electricity supply conditions offered in recent years. There was new participation in the electrotechnology implementation assistance program, and consolidation of the risk-and-profit-sharing strategy through the signing of new agreements, which will result in considerable industrial investment in Québec in coming years.

In November Hydro-Québec inaugurated a new facility to sustain future development of industrial applications of electricity – the electrochemistry and electrotechnology laboratory (LTEE) in Shawinigan. Here, in collaboration with industrial partners, testing will be done on new concepts for the use of electricity in manufacturing and

transformation processes. Also, the dual-energy program for the commercial, industrial and institutional sectors achieved remarkable success, assuring us a promising market entry.

The year marked a turning point for exports. New commitments concluded with neighboring systems both in Canada and the United States have enabled us to sell all the surplus energy that will be available until 1995 and thus realize our immediate export marketing objective.

In addition, during the year and early in 1988, Hydro-Québec concluded agreements for the long-term supply of 2,400 megawatts of firm power, which represents more than two-thirds of the maximum export sales objective for the year 2000. These firm sales could bring in revenues of about $40 billion between 1990 and 2020 and will entail building certain facilities earlier than planned.

During the year, pursuant to the export agreement signed in February with Central Maine Power Company, Hydro-Québec created a new wholly-owned subsidiary, Somarex Inc. This subsidiary will become joint shareholder with Central Maine Power Company of a future company to be responsible for building and operating a substation and transmission line in the State of Maine.

In June and December, Hydro-Québec participated in National Energy Board Canada hearings on Hydro-Québec's application for an export licence to execute the contract signed in 1985 with the New England Utilities. Refused in June, Hydro-Québec's request was taken under consideration after the December hearings, and early in 1988, the NEB announced that Hydro-Québec's request for a licence had been granted.

Improved financial situation

Since 1985, Hydro-Québec has endeavored to improve its financial ratios, which had declined sharply in 1984. It was not only a matter of ensuring its profitability and preserving the confidence of its financial partners but of allowing for sufficient margin of manoeuvre to meet the commitments of coming years. The turnaround was sought through increased revenues from sales, improved expenditure control and reduced financial expenses and risks.

Continued application of these measures in 1987 enabled the utility to improve its principal financial ratios for the third consecutive year. The challenge now is to maintain this improvement in coming years, and especially to increase the capitalization ratio through rigorous debt management.

Some noteworthy events

On July 14, unusually violent storms struck the Montréal area causing widespread flooding and depriving some 400,000 Hydro-Québec customers of electricity. At the height of the bad weather, 194 distribution circuits were out of service and many system installations, including transformers, computer systems, substations and manholes were inoperative or flooded. Personnel in the area and surrounding regions were quickly mobilized and by the next day 313,000 customers were reconnected to the main system. It took longer to restore service in the other cases because complex technical difficulties were exacerbated by another severe storm four days later.

Throughout the year there were numerous exchanges with the Québec government on the direct-current power line between Radisson, Nicolet and Des Cantons substations, which will serve to meet some of the requirements of southern Québec and to export energy to New England in the early 1990s. The crucial element in these exchanges is the St. Lawrence River crossing, which requires reconciling the economic, technical and environmental aspects of the project. In November, the government decided on an underwater crossing, but stressed the need for Hydro-Québec to respect its contractual commitments of the next decade, both in Québec and New England. It therefore asked the utility to study solutions for a temporary arrangement to provide for the necessary delivery guarantees, if required.

In October Hydro-Québec participated in hearings of the standing committee on the economy and employment of the Québec National Assembly on subcontracting at Hydro-Québec. Because of the variations in its work load, subcontracting constitutes a major management tool at Hydro-Québec. It also represents a considerable source of activity for Québec firms doing business with Hydro-Québec. However, in recent years the amount of construction work has greatly decreased and this decline has affected utility employees as well as outside contractors. Hydro-Québec is continuing exchanges with its partners in this matter, both subcontractors and unions, in order to find an optimum balance between their respective wishes and its needs.

Changes in the Board and Senior Management

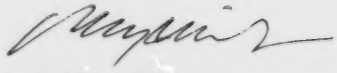
Six new members were appointed to Hydro-Québec's Board of Directors in 1987. They are Jean A. D'Argensio, Robert Demers, Jean-André Élie, Pierre H. Lessard, Michel Plessis-Bélair and Charles-Albert Poissant. They replace Gérald Aubin, Marcel Dutil, Jean-Paul Gignac, Pierre Goyette, Guy Joron and Jean-Joseph Villeneuve. We wish to welcome the new members and warmly thank those who have left for their valuable collaboration.

We wish, too, to note the appointment of Jacques Finet and John A. Hanna as respectively Executive Vice President, Internal Markets and Executive Vice President, Finance and Administration, and express our appreciation to Pierre Godin and Laurent Hamel, who left the utility in 1987.

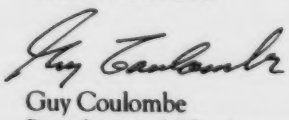
In tribute

On behalf of the Board of Directors, management and the entire staff of Hydro-Québec, we wish to pay homage to René Lévesque, former Prime Minister of Québec, who died in November. Architect of the creation of Hydro-Québec as it is today, he leaves with all of us the memory of a man of conviction, who over many years, guided the people of Québec along the road of discovery and affirmation.

And, as 1987 is the last full year that we will serve as Chairman of the Board and President and Chief Executive Officer of Hydro-Québec, we wish to warmly and sincerely thank all the staff of Hydro-Québec and its subsidiaries as well as the many people outside the utility with whom we have had the pleasure of working during our years in office. We would particularly like to express to them our feelings of pride and respect for the immense task we were able to accomplish together. And we wish all those associated with Hydro-Québec every success in the future projects they will undertake to ensure the vitality of this great enterprise which plays an ever-increasing role in the fortunes of Québec.



A. Hervé Hébert
Chairman of the
Board of Directors



Guy Coulombe
President and Chief
Executive Officer

1987 – a year marked by continuity. In all sectors of activity, the utility worked on numerous projects and programs begun in prior years. But it also strove to streamline its activities, custom tailor its products, and more narrowly target its markets. The year's highlights reviewed on the following pages illustrate the results of that dynamic approach.

The Québec Markets

Overall volume of sales of electricity in Québec rose by 5.9% in 1987 to reach 124.1 billion kilowatthours. The industrial sector, the principal focus of expansion, led the way with a leap of 14.2%, followed by the general and institutional sector with a strong increase of 7.7%. The residential and farm sector remained relatively stable. Revenue from sales in Québec totaled $4,327 million, up 7.5% from 1986. (See detailed analysis in the Financial Review section.)

Stimulating marketing policy

Hydro-Québec's marketing policy was formulated in 1986 and communicated company-wide in 1987. It contains four general tenets: satisfaction of customer needs, optimal profitability, mobilization of employees, and harmonization with government orientations.

This marketing policy marks a crucial stage in the customer-oriented focus adopted in 1985. A major refocusing of this type requires progressive changes in culture and attitude and the marketing policy gave it fresh impetus by defining common values, common goals and common terms for all employees.

Concrete achievements

Several concrete achievements were recorded during the year on the Québec market:

- revision of business practices to update them, facilitate business relations and offer better customer service;
- introduction of technological innovations: the gradual introduction of computerized meter reading, a trial recorded messageboard to give customers information registered on a standard microcomputer, and a pilot project for remote load shedding of water heaters and heating systems;
- personalization of customer relations to meet specific needs, including those of the visually and hearing impaired;
- continuing discussion with consumer groups on improvements in business practices, notably on collection of outstanding payments and the needs of low-income customers;

Metals.

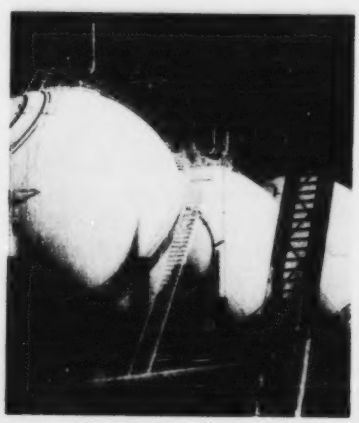
- assembly in a single document, the *Bylaw establishing the conditions governing the supply of electricity*, of all the rights and obligations of Hydro-Québec and its customers in the area of electricity supply, except for rates which are covered by a separate bylaw. The new bylaw was approved by the Québec government and distributed both company-wide and among the public at large;
- additional sensitization of employees concerning the customer focus and active participation of employees, especially in the regions, where they are in direct contact with customers.

Attractive new products

Market development and preservation are other important facets of Hydro-Québec's marketing activity, and in 1987 a number of products were offered which were both cost-saving for customers and more profitable for company operations:

- a new dual-energy program for business, industry and the institutional sector comprising a grant and a new advantageous, across-the-board rate for all energy consumed;
- a new program called "Dual Energy Plus" for single-family dwellings and apartment buildings which offers free expert evaluation of the heating system, a special cost-saving rate (Peak-Off-Peak) and a maintenance and service program with an accompanying grant.

Sales of firm electricity in Québec



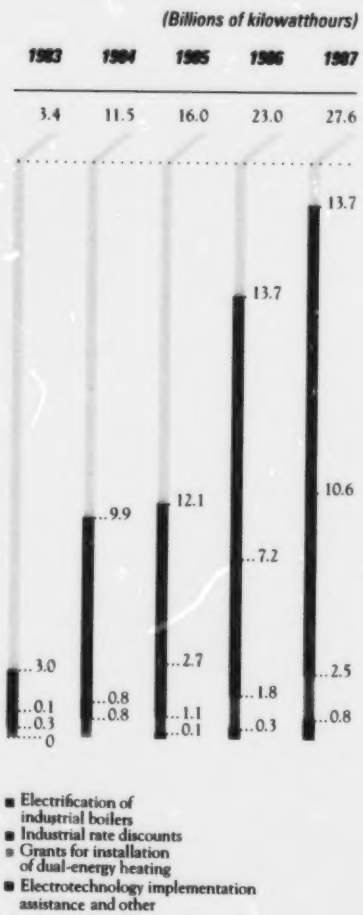
Pétromont Inc.
Winner of the Mérite industriel 1987 *for excellence in the area of energy efficiency at its Varennes plant.*

Targeting the industrial sector

Hydro-Québec was particularly active in the industrial sector, which offers considerable potential for sales of electricity. To increase its market share in this sector, it engaged in several initiatives:

- continuation of the electrotechnology implementation assistance program, which, since its introduction in 1985, has seen the signing of 275 agreements representing 268 megawatts of capacity and revenue of $27 million;
- broadening of the interruptible-power program, for which the discounts were increased;
- continuation of the risk-and-profit-sharing strategy. Introduced in 1986, this strategy offers energy-intensive industries rate reductions over several years, in return for a share of eventual profits. These contracts aim at attracting new industry into Québec and assisting consolidation or expansion of existing local industry. The results to date (eight contracts for a total of 812 megawatts) indicate that the concept meets a need in the industrial sector;
- Hydro-Québec and Université Laval signed an agreement to collaborate in the area of artificial lighting in the greenhouse industry, and, in conjunction with École Polytechnique de Montréal, the utility inaugurated a laboratory for industrial applications of microwaves.

Volume of sales from marketing programs



Signing the letter of intent between Hydro-Québec and Central Maine Power Company on February 10, 1987. *Left to right: Donald F. Kelly and John W. Rowe of CMPC, and Guy Coulombe and Jacques Guevremont of Hydro-Québec.*

Export Markets

Hydro-Québec was extremely active on export markets in 1987, and made major progress toward its export development objectives.

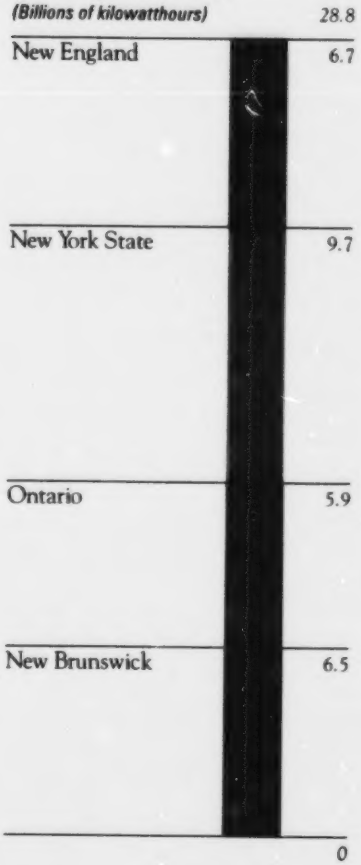
New long-term penetrations

The utility consolidated its position on export markets by negotiating new long-term deliveries of firm electricity. During the year, two major agreements of this kind were signed:

- in February, a letter of intent with Central Maine Power Company for the supply, from 1992 to 2020, of a block of firm power of from 400 to 900 megawatts and allied energy up to 122 billion kilowatthours. Revenue from these sales is estimated at $15 billion (in current dollars).
- in December, a major contract with Vermont Joint Owners providing for deliveries up to a possible 500 megawatts of firm power and 70 billion kilowatthours of firm energy between 1990 and 2015. This contract is expected to result in revenues of close to $8.6 billion (in current dollars).

In addition, early in 1988, Hydro-Québec and the New York Power Authority ratified a major agreement in principle for the sale, between 1995 and 2016, of two blocks of 500 megawatts of firm power capable of producing up to 130 billion kilowatthours of energy. Revenues associated with this agreement are estimated at $17 billion (in current dollars).

Breakdown of export deliveries outside Québec in 1987



These new commitments have enabled the utility to realize more than two-thirds of the second phase of its export sales objective, which is 3,500 megawatts of firm power before the year 2000. The deliveries provided for under these agreements will entail the forward scheduling of a number of construction projects.

Surpluses fully exploited

In addition to achieving long-term export penetration, Hydro-Québec concluded several agreements with neighboring systems in Canada and the United States that will enable it to sell all its expected surplus power and energy until 1995. They included:

- two agreements with the New Brunswick Electric Power Commission: one for the sale of 50 megawatts of power and use of associated energy between 1987 and 1990; the other for delivery of an amount of firm energy up to 17 billion kilowatthours between 1988 and 1994, with the possibility of adding up to 300 megawatts of power between 1990 and 1993;
- the sale of short-term blocks of firm power, mainly to Ontario Hydro, the New Brunswick Electric Power Commission, Niagara Mohawk Power Company, in New York State, and the New England Power Pool.

These firm deliveries replace sales of interruptible power, and will make an important contribution to market stabilization and maximization of revenue from the sale of surpluses.

Human Resources

Export permits

During the year, Hydro-Québec obtained the necessary permits from Canada's National Energy Board for the short-term delivery of firm power and energy to the States of Vermont and New York. In June and December it participated in NEB hearings on Hydro-Québec's firm energy exports to New England Utilities scheduled to start in 1990. The NEB took Hydro-Québec's application for a licence under consideration after the December hearings, and early in 1988, announced that the licence had been granted.

A new subsidiary: Somarex Inc.

To meet the conditions of the agreement signed in February with Central Maine Power Company, Hydro-Québec created a new wholly-owned subsidiary, Somarex Inc. The new company and Central Maine Power Company will create a jointly-owned power transmission subsidiary, with responsibility for design, construction, financing and operation of a direct-current transmission line and converter substation in the State of Maine.

Increase in deliveries

Total volume of electricity sales to neighboring systems in Canada and the United States reached 28.8 billion kilowatt-hours in 1987, an increase of 6.8% over 1986 and accounted for 18.8% of Hydro-Québec's total sales. Revenue from export sales totaled $713 million, an increase of 9.9% over 1986 and represented 14.1% of Hydro-Québec's revenue from electricity sales. (See detailed analysis in the Financial Review section.)

In the area of human-resource management, 1987 was a year of consolidation. Activities were centred on two objectives: continuing joint efforts with employee groups to harmonize their aspirations with the objectives of the utility, and reappraisal of practices requiring adaptation to the new management context.

Towards a revision of management practices

In 1987 there was marked progress in discussions with the unions regarding revision of Hydro-Québec's work code to include methods of "padlocking." Government health and safety regulations require that certain machinery be padlocked to avoid accidental start-up, and application of this regulation had created some difficulties. These problems are now being resolved.

Intensive discussions on the subject of subcontracting continued throughout the year. Both Hydro-Québec and its union partners sought to interpret the clause in the collective agreements dealing with division of assignments between in-house and outside personnel. Generally, maintenance work is done by Hydro-Québec employees and construction work under outside contract. At present far less work is being subcontracted than in the past. The Commission permanente de l'économie et du travail (standing committee on the economy and employment) of the Québec National Assembly examined the issue in October. At the hearings, the utility argued that its decreased recourse to outside contractors was temporary, and that it retained its policy of subcontracting but would continue the dialogue with its subcontractors and unions, in order to resolve the problems.

Success in joint efforts

In collaboration with its union locals, Hydro-Québec introduced a program of employee assistance aimed at employees with problems of alcohol or drug dependency. The terms of the program were agreed to with the unions and the program itself is original in that colleagues provide the assistance in the workplace.

Cooperative action also produced results in the equal opportunities program:

- To promote the hiring of women in trades where they have traditionally been absent Hydro-Québec ran a pilot project for line workers. Eight women successfully completed the training and are now employed as line workers within the utility.

Pulp and paper.

New horizons.
Distribution lineworkers.

- Hydro-Québec continued its program to prepare women for management positions. Originally experimental, this program was made permanent in 1987. It offers 10 management internships.
- A consultative committee on equal opportunity for women was set up. Comprising women managers and specialists, it offers women employees in these two employment categories a permanent tribune from which to better integrate their preoccupations with the orientations of the utility.

New collective agreement with engineers

A two-year period of negotiations with the Syndicat Professionnel des Ingénieurs de l'Hydro-Québec resulted during the year in the signing of a new collective agreement.

Implementation of the law to protect non-smokers

As an agency of the Québec government, Hydro-Québec is subject to the *Act respecting the protection of non-smokers in certain public places*, which became effective in 1987. Hydro-Québec designated the places in its buildings where smoking is now prohibited by law.

Installations

The diversity of the year's achievements in the area of installations faithfully reflects the many facets of system operation and development. However, the focus was on two objectives: increasing system reliability and preparing for the future.

Improved transmission

Hydro-Québec undertook a study during the year on new transmission-system design criteria to improve system performance and reduce the risks of general power failure. Increased system reliability will facilitate the attainment of export objectives and benefit the domestic market as well.

Automation of distribution control centres

At year end, 11 of the 16 distribution control centres had received their automatic equipment, and nine had been placed in service. Software developed for the first phase of the project went into service at two of the centres.

Centennial of Canadian engineering: 735-kV transmission honored. *Left to right: Brian Mulroney, Prime Minister of Canada, Bernard Lamarre, Chairman of the Centennial Commission, and Guy Coulombe, President and CEO of Hydro-Québec.*

Greater efficiency in maintenance

Hydro-Québec introduced a number of measures to reduce the effect of maintenance work on the availability of installations and to increase the efficiency of the maintenance work, including:

- installation of a surveillance system for circuit breakers at Boucherville substation;
- development of an automated test truck to check apparatus at transmission substations; 12 trucks are now being manufactured;
- use of IRECA steel to repair turbines; this new stainless steel is ultra-resistant to cavitation.

Development of interconnections continues

Work continued on the direct-current interconnection between Radisson, Nicolet and Des Cantons, which will serve to meet the needs of southern Québec and to export electricity to New England in the early 1990s. The year's expenditures on this project totaled $233 million, and mainly involved engineering work for the converter-substation components, construction of structures and commencement of line-construction between Radisson substation and Rupert River. The project is being carried out as planned, except for the St. Lawrence River crossing for which Hydro-Québec received government authorization only in November 1987.

Deliveries provided for in the letter of intent with Central Maine Power Company will require construction of an interconnection with that system. Estimation of the preliminary design was approved by the Board of Directors in August and consultations on the line corridors began in November. Commissioning is scheduled for November 1992.

Construction of additional generating capacity at existing power plants moves ahead

Work on installing additional capacity at Manic 5 continued on schedule. By year-end, concreting of the powerhouse was well advanced and installation of the generating units was under way. The year's work at this site represented expenditures of about $133 million.

Capacity is also being added at La Grande 2 generating station site, where the first phase of building the construction camp was begun along with excavation of the tailrace and access tunnels. Work carried out at this site in 1987 represented expenditures of $65 million.

Daniel Johnson dam: structure secure

After several years of intensive studies and analyses, engineers and specialists consulted by Hydro-Québec finally concluded that the structure of the Daniel Johnson dam is sound and its behavior stable. The utility therefore will not proceed with the structural reinforcement as it had originally planned. But it will go ahead with a permanent thermal reinforcement to maintain the margin of security over the long term and to prevent any possibility of deterioration due to freezing.

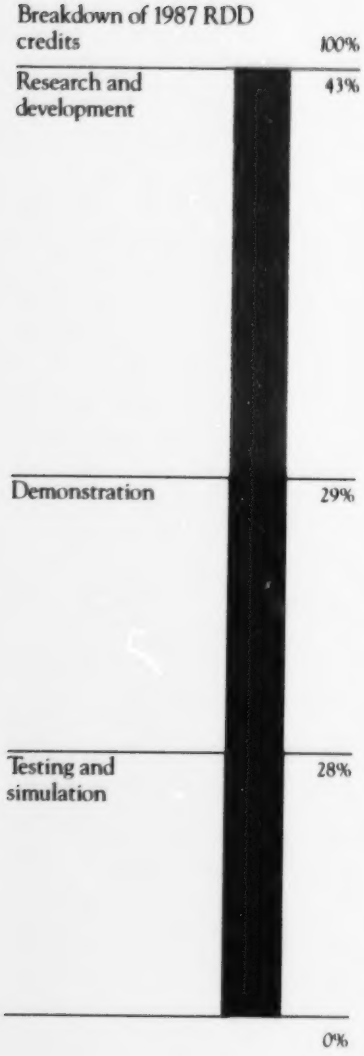
Future base-load generating stations: studies resumed

During the year Hydro-Québec drafted reports on the preliminary design studies for the La Grande 1, Laforge 1 and Brisay generating station projects in preparation for authorizations. It also undertook a study on the transmission line for the power produced by these generating stations and re-evaluated the costs and overall project plans. Construction of these three generating stations, constituting Phase II of the La Grande complex, will be scheduled according to needs for new generation.

Preliminary design studies are also under way on the Sainte-Marguerite river generating-station project.

Petrochemicals.

Technology



Technological research, development and demonstration continued to play a vital role in 1987, and some $100 million was spent in this area, including about $16 million from outside sources.

Laboratory for industrial applications

On November 6, Hydro-Québec inaugurated its new electrochemistry and electrotechnology laboratory (LTEE) in Shawinigan. An indispensable tool for the development and promotion of industrial uses of electricity, this laboratory places leading-edge installations at the disposal of Québec and other Canadian companies to test new concepts for the use of electricity in manufacturing and transformation processes.

In collaboration with industrial partners, Hydro-Québec is currently involved in 10 LTEE projects. They are principally in the area of electrotechnologies (infrared drying and magnetic induction heating), plasma technology (torch drying of mineral dust), and industrial chemistry and electrochemistry (production of hydrogen, molten-salt electrolysis and electrosynthesis).

The Québec and federal governments are also participating in the activities of LTEE by granting it $10 million in credits for industrial research and demonstration between now and 1990 to meet needs in various sectors of Québec industry.

System improvements

Throughout the year, Hydro-Québec researchers and specialists pursued numerous activities to improve system operations and installations. Among the more noteworthy were:

- development of an SF_6 circuit breaker capable of operating in very low temperatures, with testing successfully carried out at –50°C;
- completion of field and laboratory tests begun two years ago on various types of insulators, resulting in the selection of products most resistant to pollution contamination. They will be installed on the high-voltage direct-current transmission line between Radisson, Des Cantons and New England;
- testing of the world's first air-cored smoothing reactor designed for 500-kilovolt direct-current lines. This reactor will be installed on the Radisson-Des Cantons line to help stabilize the current;
- conclusion of laboratory testing of the first prototypes for failsafe distribution surge arresters and development of a preindustrial prototype which will be tested on the system in 1988.

Improved operating tools

The utility also pursued numerous activities in response to increasingly complex system management and operating requirements. They included:

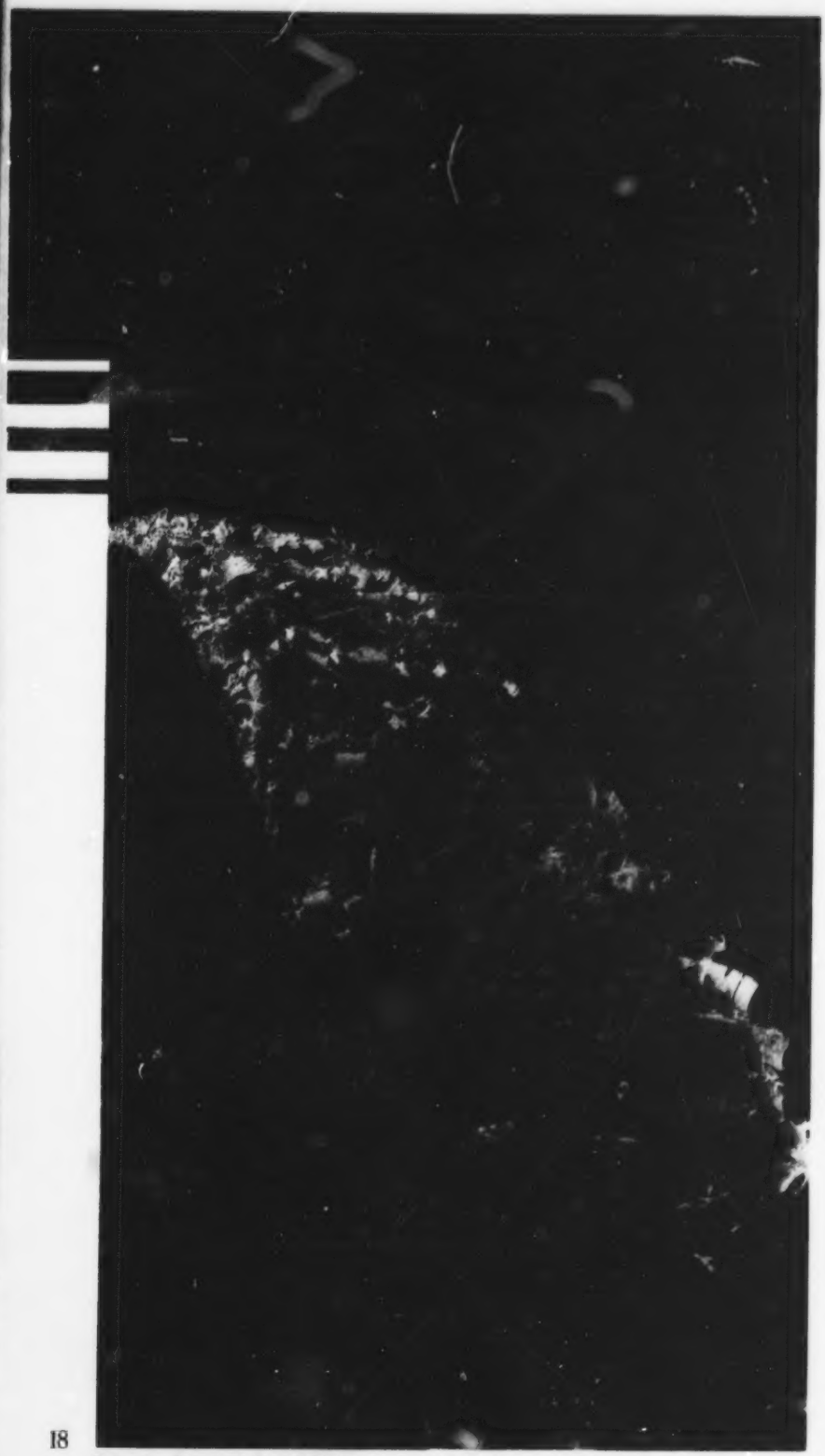
- development of a grounding for 600-volt floating systems. The resistance eliminates overvoltages which sometimes occur on the neutral component and which can pose a danger for line workers;
- continuation of the robotics research program, with successful initial testing, on cavitation-damaged turbines, of a compact robotized welding system developed in collaboration with Ontario Hydro;
- commencement of a pilot digital mapping program in collaboration with Bell Canada. This experiment is one of the many research and development projects provided for in a framework agreement signed by the two utilities in 1986. The study and test centre for outside systems built by Bell Canada on the grounds of Hydro-Québec's research institute (IREQ) in Varennes was inaugurated during the year;
- impact study on forest fires to determine measures for preventing the short circuits that occur on power lines located in the path of forest fires.

Extending frontiers

There were several major achievements in the area of future technologies:

- the Varennes tokamak, an experimental installation for the study of magnetic confinement of plasmas for application in the area of nuclear fusion, was completed in February. It was inaugurated on June 17 and has already produced its first plasmas. Hydro-Québec also entered into association with the Institut national de recherche scientifique and Atomic Energy of Canada Limited for creation of the Canadian Magnetic Fusion Centre, which will coordinate operation of the tokamak and future research;
- in the area of wind energy, the utility made a preliminary assessment of the operation and efficiency of the Kuujjuaq pilot installation located north of the 58th parallel. The first-year results were extremely encouraging and showed promise for the supply of isolated systems in the Far North;
- following recent discoveries in the area of superconducting materials, Hydro-Québec, in collaboration with the Canadian Electrical Association, undertook a study on use of these materials in the generation, transmission and storage of electrical energy. It also participated, with Atomic Energy of Canada Limited and Canada Wire and Cable Limited, in creation of an industrial consortium which will work in this area.

A fusion of present and future: the Varennes tokamak.



Drying of materials at LTEE.

Infrared radiation measurement.

Products with economic spinoff

In 1987 Hydro-Québec granted several manufacturing and marketing licences to Québec and other Canadian firms for products it had developed and which have world-wide marketing potential. For example:

- a licence to Positron Industrie Inc. for marketing an electromagnetic dosimeter. A valuable tool for environmental impact analysis, this device measures the electrical and electromagnetic fields of transmission lines;
- a manufacturing and marketing agreement with BG Checo International for a capacitor divider which allows tapping high-voltage transmission lines to supply isolated loads of 100 kilowatts;
- a licence to the compression molding division of Lyster Limited for exclusive manufacture and world-wide marketing of arm-articulated spacer dampers.

International Activity

Now entering its tenth year of operation Hydro-Québec International in 1987 took stock of its activity, re-examined its targets and redeployed its strategy of intervention in the international professional-services market.

Africa: increasingly diversified services

In Africa services were offered in a wide range of fields, enabling Hydro-Québec International to consolidate its position in several countries and make inroads in others. Major interventions included:

- continuation of a major technical training and assistance program at the Société Nationale d'Électricité du Cameroun and updating of a study for the construction of the 200-megawatt Nachtigal power station on the Sanaga River;
- completion of engineering studies for the Bamako-Ségou interconnection in Mali;
- assignment of technical advisers to the Société Nationale d'Électricité du Sénégal in the fields of system operation, and customer-accounts and financial management;
- completion of the study on line routes for the Organisation pour la mise en valeur du fleuve Sénégal within the framework of the Manantali project;
- the carrying-out of supplementary studies on movements at the N'Zilo dam in Zaïre;
- completion of the second phase of the technical-assistance contract with the Société Nationale d'Électricité de Guinée;
- commencement of a feasibility study for construction of a 400-megawatt pumped-storage plant near the Beni Haroun dam in Algeria.

Asia: a widening market

Hydro-Québec International made new progress in Asian markets in 1987. Interventions included:

- team intervention in Bangladesh for the second phase of the system control centre of the Bangladesh Power Development Board. The number of power plants and substations linked to the centre will thus be increased from 15 to 40. Hydro-Québec International also began evaluation of the operating and maintenance methods used by Bangladesh Power Development Board at its power stations and substations;
- participation in the feasibility study for the construction of a 120-megawatt hydroelectric plant on the site of the Taunsa dam on the Indus River in Pakistan;
- in China, the Three Gorges feasibility study being carried out by a Canadian consortium that includes Hydro-Québec International is nearing completion.

Latin America: emphasis on advanced technologies

Hydro-Québec's actions in Latin America were carried out primarily by the employees of IREQ. They included:

- technical assistance in the engineering, management and operation of substations and 800-kilovolt lines in Venezuela;
- a study of harmonics on the system of Electroperu in Peru, with an accompanying transfer of technology;
- engineering work on an experimental high-altitude line in Peru;
- completion, as part of the SISTECOM (Bogota) – Hydro-Québec International consortium, of several studies on reducing energy losses and improving service continuity on the Cali distribution system in Colombia;
- technical assistance to the Colombian consortium Consortio Lineas Guavio for validation of studies the consortium is conducting on construction of two 230-kilovolt lines.

Spinoff of the Francophone Summit

In September, at the request of the Québec government, and in the framework of the Conference of Heads of State and governments of the world's French-speaking community, Hydro-Québec launched a program of cooperation and training for electric-utility management. The program's objective is to place Hydro-Québec's technological expertise and administrative know-how at the disposal of electric utilities to help solve their planning, operations, and management problems. Hydro-Québec will allocate $5 million to the program over the next five years and Hydro-Québec International will manage the individual training and cooperation projects.

Hydro-Québec in its Environment

Hydro-Québec is a major presence throughout Québec, as operator of the province's electric power system, supplier of electricity and purchaser of goods and services. In addition to its role as an economic agent, it has clear responsibilities with regard to the physical and human environment in which it conducts its activities. It therefore has a multi-faceted involvement in the life of the Québec community.

Environmental considerations

In 1987 Hydro-Québec continued to carry out studies on the impact of its construction projects and to ensure environmental protection in its operating and maintenance activities. One study evaluates the possible impact of the build-up and interaction of the environmental effects of future installations. This study, which will be spread over several years, aims at ensuring that environmental acceptability will be as important a consideration in construction projects as technical and economic feasibility.

Hydro-Québec also updated the plan of action it had adopted in 1986 to determine whether electric and magnetic fields have an effect on the health of animals and humans. Under this plan it signed an agreement with Bonneville Power Administration to study livestock and crop farming. Discussions were also started with Ontario Hydro and Électricité de France for a joint epidemiological study on exposure to 60-hertz electric fields.

Hydro-Québec made a contribution to the Fondation de l'Université du Québec à Montréal for creation of a Research Chair in environmental studies, and continued collaborating with the Université de Montréal in the organization of a series of Hydro-Québec sponsored lectures on development of the urban environment. The 1987 series, the third in this program, was entitled "The City and the Water" and, like its predecessors, attracted speakers of international renown.

Relations with Native Peoples

The year's activities largely involved implementation of the three agreements signed in 1986 by Hydro-Québec and the Cree Indian community of Québec. They included:

- creation of the Eeyou Corporation of James Bay. Managed by the Cree, the Corporation, among other functions, will administer the *La Grande (1986) Agreement* and the payments it provides for. The Eeyou Corporation will be an important forum for both the Cree and Hydro-Québec;
- payment to the Cree community of compensation as stipulated in the agreements;
- assistance in the creation of a James Bay mercury committee in accordance with the *Mercury Agreement (1986)* between the Cree of Québec and Hydro-Québec which provides for a program to help solve the problem of mercury methylation in the lakes and reservoirs of this region of Québec. The program comprises three phases: health considerations, socio-economic and cultural matters, and the environment.

In addition Hydro-Québec continued discussions with the Inuit on application of the *James Bay and Northern Québec Agreement*, and on evaluation of the impact on navigation at Kuujjuaq of the Caniapiscau River diversion. It also began discussions with the Attikameks and Montagnais on the impact on their activities of the Radisson-Nicolet-Des Cantons transmission line and the Sainte-Marguerite project.

Joint action with the regional-county municipalities

During 1987 Hydro-Québec collaborated closely with the regional-county municipalities (MRCs) in the completion of their development plans. It endeavored to sensitize the MRCs to the constraints it faces in developing the electrical grid and took the considerations of the MRCs' development objectives into account in its activities. Similarly, the MRCs were able to take Hydro-Québec's constraints into consideration in their planning process.

Contribution to economic development

Through its capital expenditures, Hydro-Québec injected more than $1.5 billion into the Québec economy during the year. And its overall activity sustained considerable direct and indirect employment: nearly 52,000 personyears.

The advancement of science

Again in 1987 Hydro-Québec sponsored one of the awards of the Association canadienne-française pour l'avancement des sciences, which acknowledges outstanding work in scientific research. Known as the prix Michel-Jurdant, the award is given in the area of the environment.

Hydro-Québec also provided sponsorship for Expo-sciences international 87 organized by the Conseil de développement du loisir scientifique. Human, technical and financial resources were made available by the utility to promote this international meeting of young scientists.

Social commitment

Every year Hydro-Québec supports numerous social and cultural activities and its personnel is active in a wide range of community actions and volunteer work. Typical of these activities are the Centraide (United Way) fund-raising campaign, the campaign to assist persons with severe burns, the Mira Foundation which provides seeing-eye dogs, and the Jeunes entreprises program sponsored by managers and specialists at Hydro-Québec.

Hydro-Québec met the challenge it had set itself for 1987 by achieving the dual goal of market expansion and an improved financial situation.

Overall revenue from electricity sales rose 7.8%, largely reflecting the marketing effort undertaken during the year and in the recent past.

Overall expenditure was up 8.1%. The margin of manoeuvre provided by the increased revenue, and a decline of 4.0% in interest expense, enabled the utility to accept a growth in operating expenses of 10.2%. This permitted it to intensify activity tied to special projects and programs, especially in the area of system operation and maintenance.

Its principal financial ratios improved and the utility ended the year with a net income of $508 million, an increase of $205 million over the previous year.

Sales and revenue rise

The volume of Hydro-Québec's total sales reached 152.9 billion kilowatthours in 1987, compared with 144.1 billion kilowatthours in 1986, an increase of 6.1%. Revenue from sales of electricity was $5,040 million, 7.8% more than in 1986. Gross revenue, which includes other operating income, totaled $5,095 million, against $4,734 million in 1986.

Québec sales

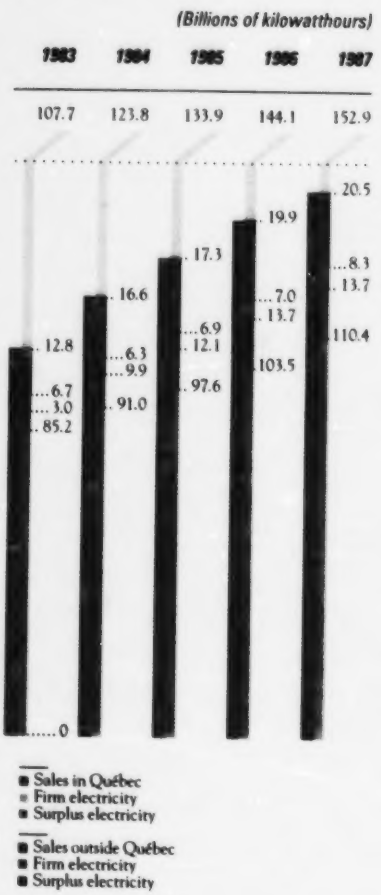
Sales of electricity in Québec totaled 124.1 billion kilowatthours, up 5.9% over 1986. Revenue from these sales totaled $4,327 million, 7.5% more than in the previous year.

Sales of firm electricity in Québec rose by 6.6% to 110.4 billion kilowatthours. This was a noteworthy result, in view of the 0.3% decrease in sales in the residential and farm sector. Revenue from firm sales in Québec totaled $4,183 million, an increase of $326 million, which includes $116 million from the 4.6% rate increase that became effective May 1, 1987.

- ***Residential and farm sector:*** **−0.3%**

Two factors had an unfavorable effect on deliveries in this sector in 1987: mild weather accounted for about one billion kilowatthours of the decline from 1986, and the lower unit consumption in Québec households accounted for 0.9 billion kilowatthours. However, exceptional growth in new construction – 70,000 housing starts in 1987 – somewhat offset the negative elements. Revenue from residential and farm sales rose by 5.1% or $46 million over 1986, mainly because of the rate increase of May 1987.

Total electricity sales

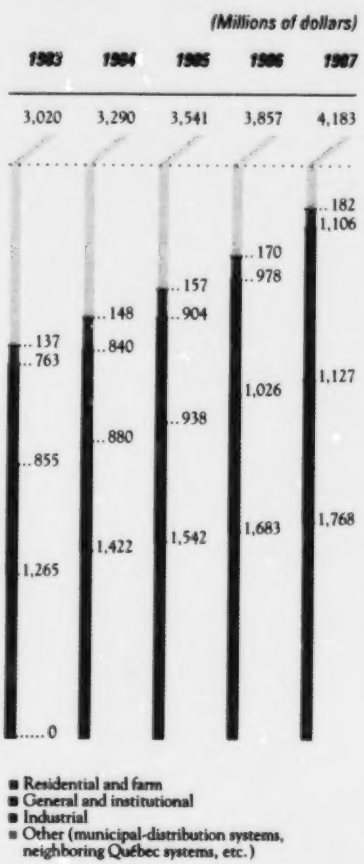


Gross revenue

- ***General and institutional sector:* +7.7%**
The growth rate in the general and institutional sector was higher in 1987 than in 1986, a year when it was exceptionally high. The resounding success of the dual-energy program in the commercial and institutional sectors, combined with the rise in renovations and new construction, resulted in a sales volume of 23.9 billion kilowatthours, 1.7 billion kilowatthours more than in 1986. Revenue from these sales was up $101 million over the previous year to $1,127 million. The rate increase of May 1987 accounted for $32 million of the additional revenue.

- ***Industrial sector:* +14.2%**
This sector recorded its highest growth since the start of the decade and contributed largely to the increase in firm electricity sales in Québec. The result is attributable to the good performance of several sectors of industrial activity, including smelting and refining (especially aluminum works), pulp and paper, and chemicals. In addition, there were fewer work stoppages than in 1986, another factor that favored increased deliveries. Revenue from sales to industry totaled $1,106 million, an increase of 13.1% or $128 million over 1986, of which $33 million was attributable to the May 1987 rate increase.

Revenue from firm electricity sales in Québec



- ***Surplus electricity:* +0.6%**
The growth of total surplus electricity sales declined markedly in 1987, and revenue from these sales was down by $23 million or 14.2% from the previous year.

Sales of surplus electricity in the general and industrial sectors rose by only 0.1%, because this market had already matured in 1986.

Revenue from surplus electricity sales declined $27 million from 1986 as a result of the drop in oil prices early in 1987. However, sales to neighboring Québec systems rose by 6.6% and revenue from these sales by 24.1%.

Export sales

The volume of electricity sales to neighboring Canadian and American systems totaled 28.8 billion kilowatthours compared with 26.9 billion kilowatthours in 1986, an increase of 6.8%. Revenue from these sales reached $713 million, up 9.9% over 1986. Deliveries to the United States rose from 12.6 billion kilowatthours in 1986 to 16.4 billion kilowatthours in 1987, a growth of 30.1%.

The increase in sales volume was particularly noteworthy during the summer months on the U.S. markets. In the third quarter, Hydro-Québec delivered a total of 4.7 billion kilowatthours to New York State and New England, compared with 3.0 billion kilowatthours during the corresponding period of 1986. Commissioning of the interconnection with the New England Power Pool late in 1986, and the increase in the carrying capacity of the interconnection with New York Power Authority to 1,850 megawatts, gave Hydro-Québec greater access to these markets during the summer peak.

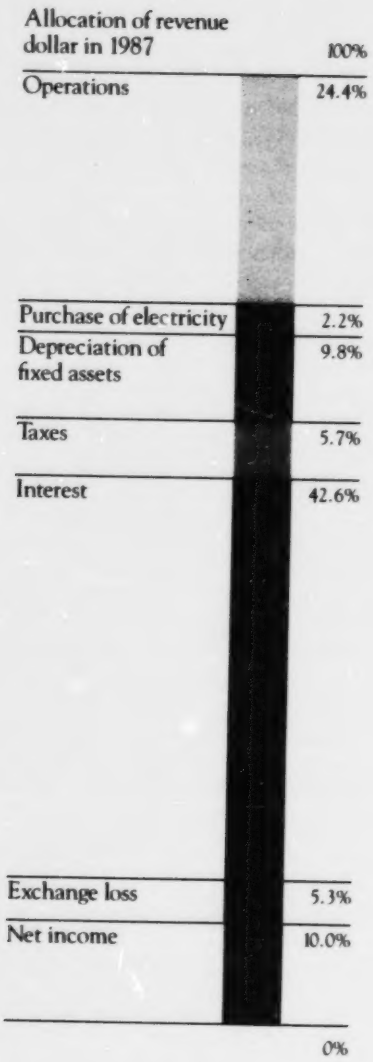
In addition, total firm power and energy exports increased 19.1% from 7.0 billion kilowatthours in 1986 to 8.3 billion kilowatthours in 1987. Revenue from these sales rose to $256 million, up 5.6% over 1986. Most of the increase was in sales to the New Brunswick Electric Power Commission and Niagara Mohawk Power Company in New York State.

Revenue from export sales

Expenditure

Total expenditure rose by 8.1% in 1987 to $2,145 million. Operating expenses, which accounted for $1,246 million, were up by $117 million or 10.2% over the previous year. This increase is mainly attributable to increased activity on a number of special programs and projects in the area of system operation and maintenance ($20 million); to cancellation of the project to reinforce the structure of the Daniel Johnson dam and write-off of the costs already incurred for the project ($25 million); to the overall increase in regular activity and in the number of personnel ($25 million), and to the effect of inflation.

Electricity purchases totaled $110 million, a decline of 5.9% from 1986. Depreciation of fixed-asset expense rose by 7.6% to $500 million, largely as a result of improvements to the distribution system. Taxes, for their part, were up 6.3%, mainly due to higher taxable value, the increased rate of capital tax introduced in May 1986 and the rise in tax on gross revenue.



Interest

Interest charged to operations totaled $2,170 million, 4.0% less than in 1986. Refinancing of long-term debt at better rates had a positive effect on interest on borrowings.

Interest charged to Construction in progress rose by $64 million, or 49.5%, due to increased construction work in 1987: additional capacity at the La Grande 2 site, and preliminary design studies for La Grande 1, Laforge 1, and Brisay generating stations.

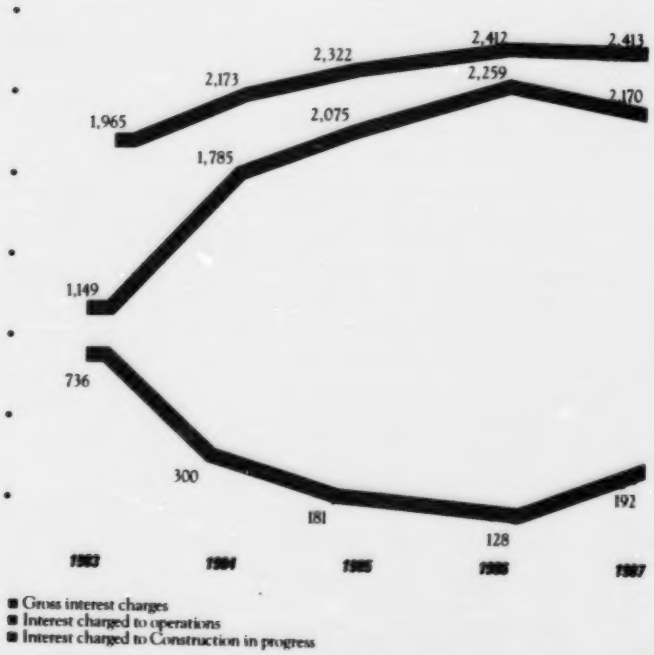
Exchange loss $83 million higher

Exchange loss stood at $272 million, compared with $189 million for 1986. In 1987, this item mainly comprised amortization of unrealized exchange loss on debt in European currencies and the Japanese yen; therefore, the considerable appreciation of these currencies during the year largely explains the $83 million increase.

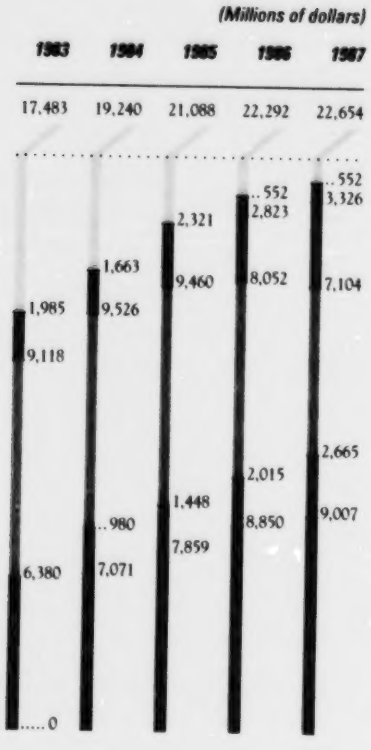
Debt growth slows

Hydro-Québec's total debt reached $22.7 billion at the end of 1987, compared with $22.3 billion at the end of the previous year. Reduced needs for additional financing as of 1986 resulted in an increase in debt of almost 2.0% during the year, compared with a yearly average of 10.0% between 1980 and 1985.

Main interest components
(Millions of dollars)



Composition of total debt



- Canadian dollars
- Debt covered by swap agreements
- United States dollars
- Other currencies
- Perpetual debt

The proportion of the debt in Canadian dollars was 40.7%. The appreciation of European currencies and the Japanese yen had the effect of increasing the debt denominated in those currencies even though in reality the number of units borrowed remained the same.

Swap agreements in the amount of $902 million were issued during the year, bringing the total amount of debt thus protected mainly against exchange risk to $2,665 million by the end of 1987.

Financing

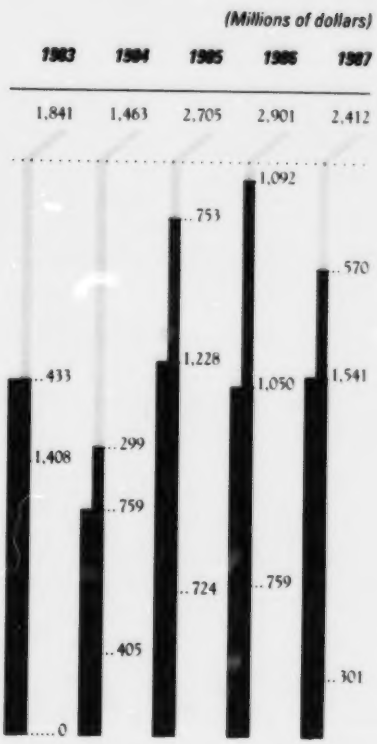
The year's financing activities reached a gross volume of $2,412 million. Net borrowings totaled $301 million, which was $458 million less than in the previous year. Renegotiation of existing borrowings amounted to $570 million, a decrease of $522 million from 1986.

To facilitate access to new short- and medium-term financing and thus increase its margin of manoeuvre, Hydro-Québec implemented two new financing programs. Under these programs, it can now issue short-term notes for a maximum of U.S.$250 million on the Eurodollar market. It can also issue medium-term notes in various currencies on the United States market, up to the equivalent of U.S.$500 million.

Capital expenditures

The volume of net investments increased by 4.0% to reach $1,496 million, compared with $1,438 million in 1986. In 1987, Hydro-Québec injected $125 million into construction of the Radisson-Nicolet-Des Cantons transmission line and $108 million into construction of related substations and other structures. It also spent $133 million on construction of additional capacity at Manic 5 generating station.

Breakdown of financing



- Funds provided by external financing
- Redemption of long-term debt
- Issue of debt
- Renegotiations

Financial ratios

To ensure sound financial management and adequate margin of manoeuvre, Hydro-Québec has set three principal objectives: interest coverage of at least 1.00, a level of self-financing equal to or higher than 30%, and a return on equity at least equal to the average cost of the debt. In 1987 interest coverage reached 1.25, for the first time in 10 years; the level of self-financing remained steady at 41.0% and the return on equity continued to increase, to reach 7.0%.

However, the rate of capitalization, which was 24.9% at year-end, did not quite reach the 25% minimum required by the *Hydro-Québec Act* before Hydro-Québec is in a position to pay a dividend to its shareholder, the Québec government.

Financial ratios and declared dividends

	1983	1984	1985	1986	1987
Interest coverage	1.04	1.10	1.12	1.15	1.25
Capitalization (%)	26.6	25.3	24.1	24.0	24.9
Self-financing (%)	40.3	34.2	35.7	41.0	41.0
Return on equity (%)	11.7	4.7	3.2	4.4	7.0
Declared dividends *(Millions of dollars)*	60	156	–	–	–

Interest coverage

$$\frac{\text{Income before interest and exchange loss + Net investment income}}{\text{Gross interest charges}}$$

Capitalization

$$\frac{\text{Shareholder's equity}}{\text{Shareholder's equity + Long-term debt + Perpetual debt + Notes payable + Long-term debt payable within one year}}$$

Self-financing

$$\frac{\text{Total financial resources provided by operations – Declared dividends}}{\text{Investments + Redemption of long-term debt}}$$

Return on equity

$$\frac{\text{Net income}}{\text{Shareholder's equity (year's average)}}$$

Financial situation of pension fund

Net assets of the Hydro-Québec Retirement Fund rose from $2,165 million to $2,425 million at the end of 1987, an increase of $260 million. The market value of the portfolio increased $102 million, to reach $2,432 million. The actuarial rate of return, calculated from the book value of the Retirement Fund, was 9.7% for 1987, compared with 12.1% for 1986.

The fund paid out $75 million in pension benefits in 1987, 6.6% more than in the preceding year. There were 5,419 pensioners at year-end, compared with 5,327 at the end of 1986. An actuarial valuation made in 1987 for purposes of financing the Retirement Fund showed a net surpluse of $130 million for the overall plan at December 31, 1986.

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MANAGEMENT REPORT

Hydro-Québec's consolidated financial statements were prepared by management in accordance with generally accepted accounting principles and approved by the Board of Directors. In the opinion of management, they were properly prepared, within reasonable limits of materiality, so as to incorporate all important elements and data available at January 29, 1988. The financial results contained in the Annual Report are based on the financial statements.

Guy Coulombe
President and Chief Executive Officer

AUDITORS' REPORT

To the Gouvernement du Québec,

We have examined the consolidated balance sheet of Hydro-Québec as at December 31, 1987 and the consolidated statements of operations, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of Hydro-Québec as at December 31, 1987 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Charette, Fortier, Hawey
Touche Ross

Samson Bélair

Charette, Fortier, Hawey
Touche Ross
Chartered Accountants

Samson Bélair
Chartered Accountants

Montréal, Canada
January 29, 1988

Consolidated Statement Of Operations

	(in millions of dollars) For the year ended December 31	
	1987	1986
Revenue		
Sales of electricity (Note 2)	**$5,040**	$4,673
Other operating income	**55**	61
	5,095	4,734
Expenditure		
Operations	**1,246**	1,129
Electricity purchased	**110**	118
Depreciation of fixed assets	**500**	464
Taxes (Note 3)	**289**	272
	2,145	1,983
Income before interest and exchange loss	**2,950**	2,751
Interest (Note 4)	**2,170**	2,259
Exchange loss	**272**	189
	2,442	2,448
Net income	**$ 508**	$ 303

CONSOLIDATED BALANCE SHEET

(in millions of dollars)
As at December 31

Assets	**1987**	1986
Fixed assets		
Property and plant (Note 5)		
In service	**$28,862**	$27,957
Less accumulated depreciation	**3,937**	3,509
	24,925	24,448
Construction in progress	**2,565**	1,948
	27,490	26,396
Current assets		
Cash and temporary investments	**162**	74
Accounts receivable	**1,087**	1,047
Materials, fuel and supplies	**223**	214
	1,472	1,335
Other assets		
Investments (Note 6)	**124**	127
Deferred expenses (Note 7)	**2,573**	2,730
	2,697	2,857
	$31,659	$30,588

Pierre Leblanc
Chairman of the Audit Committee

Guy Coulombe
Chairman of the Board
and President and Chief
Executive Officer

Montréal, Canada
February 16, 1988

Liabilities and Shareholder's Equity	(in millions of dollars) As at December 31 1987	1986
Long-term debt (Note 8)	$21,198	$20,349
Current liabilities		
Accounts payable	594	475
Notes payable	94	9
Accrued interest	786	789
Long-term debt payable within one year (Note 8)	904	1,391
	2,378	2,664
Perpetual debt (Note 9)	552	552
Shareholder's equity		
Capital stock		
Authorized 50,000,000 shares, par value of $100 each		
Issued and fully paid 43,741,090 shares	4,374	4,374
Retained earnings	3,157	2,649
	7,531	7,023
	$31,659	$30,588

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

	(in millions of dollars) For the year ended December 31	
	1987	1986
Balance at beginning of year	**$2,649**	$2,346
Net income	**508**	303
Balance at end of year	**$3,157**	$2,649

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	(in millions of dollars) For the year ended December 31	
	1987	1986
Funds provided by operations		
Net income	$ 508	$ 303
Depreciation of fixed assets	500	464
Amortization of deferred expenses	383	364
Difference between pension expense and contributions	(73)	(75)
Net loss on redemption of long-term debt	5	5
	1,323	1,061
Decrease (increase) in working capital (Note 12)	64	(254)
	1,387	807
Funds provided by external financing		
Issue of long-term debt	1,842	1,259
Issue of perpetual debt	–	550
Redemption of long-term debt	(1,541)	(1,050)
	301	759
Funds available for investment	$1,688	$1,566
Investment		
Fixed assets	$1,581	$1,470
Grants under sales programs	88	67
Other	19	29
	$1,688	$1,566

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 **December 31, 1987**

Significant accounting policies

a) Consolidation

The consolidated financial statements include the financial statements of Hydro-Québec and its subsidiary companies.

b) Rates

Under the provisions of its Act, Hydro-Québec has the mandate to supply power and to pursue endeavors in energy-related research and promotion, energy conversion and conservation, and any field connected with or related to power or energy. The rates and conditions under which power is supplied must be consistent with sound financial administration. The Hydro-Québec Act stipulates that the rates must be maintained at a level sufficient to defray at least all operating expenditures, interest on debt, and depreciation of fixed assets over a maximum period of 50 years. The rates are established by Hydro-Québec and are approved by the Gouvernement du Québec.

c) Sales of electricity

Revenue from sales of electricity is recorded on the basis of cyclical billings. It is also accrued in respect of electricity delivered but as yet unbilled.

d) Property and plant

Property and plant include generation, transmission and distribution facilities and administration and service buildings, as well as construction, operating and research equipment. They are carried at cost, which includes material, direct labor and engineering and administration overhead costs applicable to the construction program. The cost also includes interest charged to Construction in progress as explained under (f) hereinafter. The costs of additions, improvements and replacements are capitalized and expenditures for maintenance and repairs are charged to operations. At the time of retirement or sale of an asset, the cost and accumulated depreciation, less the amount realized, are transferred to a separate account; the net amount is amortized over ten years according to the sinking fund method of depreciation, based on an interest rate of 3%.

The costs of generating facilities, up to an amount equal to the accumulated cost at date of transfer, are transferred to Property and plant in service by instalments proportionate to the number of generating units of the project that are completed and in service, on the basis of the present value of the total estimated cost. The costs of transmission, distribution and other facilities are transferred to Property and plant in service when these facilities are completed and in commercial operation.

Note 1
Significant accounting policies (cont'd)

e) Depreciation

Hydro-Québec uses the sinking fund method of providing for depreciation of its property and plant (other than construction, operating and research equipment), based on an interest rate of 3% and the following expected service lives:

Hydraulic powerhouses, dams, reservoirs, transmission towers (steel) and conductors, and administration and service buildings	50 years
Hydraulic turbines and generators and distribution conductors	40 years
Nuclear power station and its turbine, generator and reactor	30 years
Distribution poles	25 years

Construction, operating and research equipment is depreciated over its expected service life according to the straight-line method.

f) Interest charged to Construction in progress

Interest is added to the cost of construction in progress at a rate equivalent to the weighted average of the effective interest rates on Hydro-Québec's debt securities issued to finance such construction and includes the exchange loss on the principal amount of this debt. This rate was 12.84% in 1987 and 14.20% in 1986.

g) Research and development

Preliminary engineering, investigation and survey costs incurred on projects before authorization for their construction is obtained are charged to operating expenditure. The cost of research and development related to alternative energy sources, or not related to a specific project, is also charged to operations.

h) Materials, fuel and supplies

Hydro-Québec values its inventories of materials, fuel and supplies on an average-cost basis.

i) Investments

All investments are shown at cost. The cost of temporary investments approximates market value.

j) Deferred expenses

Grants under sales programs

In the framework of its plan to expand the Québec market, Hydro-Québec has implemented assistance programs for the marketing of electricity. The grants for these programs are amortized on a straight-line basis over the five years after the year in which they are made.

Note 1
Significant accounting policies (cont'd)

Debt-security discount and expenses

Debt-security discount and expenses are amortized on a straight-line basis over the life of the debt to which they apply.

Delaney project

As the Delaney project has been postponed for an indefinite period, the expenses incurred for this project are amortized on a straight-line basis over three years.

Other

The other deferred expenses include various expenditures for the benefit of future years and are amortized on a straight-line basis over periods not exceeding 40 years.

k) Foreign currency translation

Revenue and expenditure resulting from transactions made in foreign currencies are converted at the Canadian dollar equivalent at the rates of exchange at the date of transaction. Monetary assets and liabilities are translated into Canadian currency at the rates of exchange at the balance sheet date, and non-monetary items are translated into the Canadian dollar equivalent at the rates of exchange at the date of transaction. However, monetary items covered by monetary agreements against exchange risks are converted into Canadian dollars at the rates of exchange established under the conditions of the relevant agreement.

The exchange gains or losses resulting from these conversions are included in the Consolidated Statement of Operations; those pertaining to the capital of long-term debt are deferred and amortized on a straight-line basis over the remaining life of the debt, except for those hedged by future revenue streams in United States dollars, which are deferred until the date of repayment of such debt.

l) Sinking fund

Hydro-Québec forms virtually its entire sinking fund through the purchase of its own debentures. It deducts these funds from long-term debt and carries them at par, which may not be indicative of cost or current market value. The resulting profit, net of unamortized discount and other expenses, is included with Interest (see Note 4).

m) Retirement plan

The costs of the retirement plan are determined periodically by independent actuaries. Pension expense is charged annually to operations and comprises the total of the following:

- The cost of pension benefits provided in exchange for employees' services rendered during the year, as calculated using the actuarial method pro rated on services, and

Note 1
Significant accounting policies (cont'd)

• Amortization over the employees' expected average remaining service life, according to the level annual contribution method, of (i) adjustments arising from changes in the plan or in assumptions, (ii) experience gains or losses, and (iii) the plan surplus determined upon adoption of the 1986 recommendations of the Canadian Institute of Chartered Accountants.

The cumulative difference between pension expense and contributions made to the retirement fund is reflected in Deferred expenses.

Note 2
Sales of electricity

Sales of electricity include $446 million ($378 million in 1986) from sales to customers in the United States.

Note 3
Taxes

(in millions of dollars)	1987	1986
Capital tax	$ 145	$ 137
Tax on gross revenue as municipal real estate tax on certain immovables	120	112
Real estate taxes	24	23
	$ 289	$ 272

Note 4
Interest

(in millions of dollars)	1987	1986
Interest on debt securities	$2,392	$2,388
Amortization of debt-security discount and expenses	21	24
Net loss on redemption of long-term debt	5	5
	2,418	2,417
Less		
Interest charged to Construction in progress	192	128
Net investment income	56	30
	248	158
	$2,170	$2,259

Note 5
Property and plant

(in millions of dollars)	1987			1986		
	Property and plant in service	Accumulated depreciation	Construction in progress	Property and plant in service	Accumulated depreciation	Construction in progress
Generation						
Hydraulic	$13,491	$ 1,588	$ 1,376	$13,492	$ 1,422	$ 1,129
Nuclear	1,455	127	13	1,453	95	10
Other	359	137	20	351	124	9
	15,305	**1,852**	**1,409**	15,296	1,641	1,148
Transmission						
Substations	2,960	353	393	2,875	309	231
Lines	4,096	482	258	4,044	436	112
	7,056	**835**	**651**	6,919	745	343
Distribution						
Substations	983	164	134	920	153	107
Lines	3,496	505	245	3,080	449	240
	4,479	**669**	**379**	4,000	602	347
Other						
Administration and service buildings	686	60	61	521	50	62
Equipment	688	372	–	597	322	–
Sundry	648	149	65	624	149	48
	2,022	**581**	**126**	1,742	521	110
Total	**$28,862**	**$ 3,937**	**$ 2,565**	$27,957	$ 3,509	$ 1,948

Note 6
Investments

(in millions of dollars)	1987	1986
Churchill Falls (Labrador) Corporation Limited (CFLCo) (see Note 13)		
General Mortgage Bonds, 7½%, due 1988 through 2010 (par value $85 million and $88 million, respectively)	$ 77	$ 79
Common shares	34	34
	111	113
Sundry investments	13	14
	$ 124	$ 127

Note 7
Deferred expenses

Deferred expenses comprise the unamortized balances of the following items:

(in millions of dollars)	1987	1986
Unrealized exchange loss	$1,890	$2,116
Grants under sales programs	246	223
Debt-security discount and expenses	193	188
Pension expense	148	75
Delaney project	15	29
Other	81	99
	$2,573	$2,730

Note 8
Long-term debt

Hydro-Québec's long-term debt is guaranteed by the Province de Québec, except for an amount of $189 million ($448 million in 1986).

Debenture and other long-term debt maturities, and sinking fund requirements, converted into Canadian dollars, are shown in the following table:

	1987		1986	
Years of maturity	(in millions of dollars)	Weighted average interest rate	(in millions of dollars)	Weighted average interest rate
1987	$ –		$ 1,391	
1988	904		1,036	
1989	1,118		1,187	
1990	1,414		1,324	
1991	1,664		2,007	
1992	1,751		–	
1 – 5 years	6,851	11.04%	6,945	11.57%
6 – 10 years	6,308	9.88%	6,189	10.73%
11 – 15 years	1,973	8.97%	1,918	9.54%
16 – 20 years	4,165	10.58%	4,315	10.20%
21 – 25 years	1,608	11.15%	1,250	11.13%
26 – 30 years	382	12.40%	613	12.20%
31 – 35 years	–	–	–	–
36 – 40 years	815	8.44%	510	8.56%
	22,102	10.39%	21,740	10.82%
Less Portion payable within one year	904		1,391	
	$21,198		$20,349	

Note 8
Long-term debt (cont'd)

Repayments to be made in Canadian dollars and in foreign currencies, with their Canadian dollar equivalent, are shown in the following table:

				1987	1986
		(in millions of units)		Total (in millions of dollars)	Total (in millions of dollars)
	1988 to 1992	*1993 to 2027*	*Total*	*1988 to 2027*	*1987 to 2026*
Canadian dollars	1,969	7,038	9,007	$ 9,007	$ 8,850
At rates established according to conditions of monetary agreement					
United States dollars	1,037	433	1,470	1,979	1,572
Deutsche marks	150	200	350	179	179
Swiss francs	100	250	350	195	195
Yen	–	35,450	35,450	312	69
				11,672	10,865
At rates in effect at balance sheet date					
United States dollars	1,115	4,352	5,467*	7,104	8,052
Deutsche marks	624	494	1,118	926	828
Swiss francs	937	456	1,393	1,425	1,181
Yen	19,116	12,884	32,000	344	279
Pounds sterling	–	150	150	368	308
ECUs	90	–	90	153	132
Guilders	75	75	150	110	95
				10,430	10,875
				$22,102	$21,740

*A proportion of 98% (97% in 1986) is hedged by future revenue streams in United States dollars.

Hydro-Québec has an undrawn revolving standby credit which expires in 1994 for U.S.$750 million. Any borrowing under this line of credit will bear interest at a rate based on the average London Interbank Offered Rate (LIBOR).

Note 9
Perpetual debt

Perpetual notes in the amount of U.S.$400 million are shown in Canadian dollars at the rate of exchange in effect at date of issue ($520 million at the rate of exchange at balance sheet date). These notes, bearing interest at a rate based on the London Interbank Offered Rate (LIBOR) established twice yearly, are guaranteed by the Province de Québec and are redeemable, at Hydro-Québec's option, beginning in 1991.

Note 10
Restrictions on dividends

Under the Hydro-Québec Act, the dividends to be paid by Hydro-Québec are declared once a year by the Gouvernement du Québec, which also determines the terms and conditions of payment. For a given financial year, they cannot exceed the distributable surplus, which is established as follows: 75% of Income before interest and exchange loss and the year's Net investment income, less interest on debt securities and amortization of debt-security discount and expenses. This calculation is made on the basis of the consolidated financial statements.

However, in respect of a given financial year no dividend may be declared in an amount that would have the effect of reducing the rate of capitalization to less than 25% at the end of the year concerned. This rate corresponds to the ratio between shareholder's equity (less dividends declared for the year) and long-term debt, plus notes payable, perpetual debt and shareholder's equity (less dividends declared for the year).

The government declares the dividends for a given year within 30 days after the transmission by Hydro-Québec to the government of the financial data relative to the distributable surplus. On expiry of the time prescribed, any distributable surplus or part thereof which has not been subject to a dividend declaration may no longer be distributed to the shareholder as a dividend.

Note 11
Retirement Plan

The Hydro-Québec Retirement Plan is a contributory, defined benefit pension plan based on final pay under which benefits payable are guaranteed by Hydro-Québec. At December 31, 1987, 19,017 employees (18,571 in 1986) were contributing to the plan. An independent actuarial valuation was made in 1987 in order to determine the present value of accrued benefits based on employees' expected basic salary until retirement. The assets of the retirement fund are valued at market value.

At December 31, 1987, the date of the most recent valuation, the retirement plan shows a surplus as follows:

	(in millions of dollars)
Retirement fund assets	$ 2,665
Present value of accrued benefits	(2,147)
Excess special contributions made by Hydro-Québec	(47)
Surplus	**$ 471**

For the year ended December 31, 1987, pension expense amounted to $12 million ($9 million in 1986).

Note 12
Decrease (increase) in working capital

(in millions of dollars)	**1987**	1986
Decrease (increase) in current assets		
Cash and temporary investments	**$ (88)**	$ (58)
Accounts receivable	**(40)**	(106)
Materials, fuel and supplies	**(9)**	12
	(137)	(152)
Increase (decrease) in current liabilities		
Accounts payable	**119**	(80)
Notes payable	**85**	(59)
Accrued interest	**(3)**	37
	201	(102)
	$ 64	$ (254)

Note 13
Commitments, contingencies and projected capital expenditures

Churchill Falls

On May 12, 1969, Hydro-Québec executed a contract with Churchill Falls (Labrador) Corporation Limited (CFLCo) whereby Hydro-Québec undertook to purchase virtually all the power generated at the Churchill Falls generating station, of a rated capacity of 5,225,000 kilowatts, for a period of 40 years from September 1, 1976, except for an amount not to exceed 300,000 kilowatts of such power which may be recaptured by CFLCo. This contract will be automatically renewed for a further period of 25 years upon already agreed terms.

By this contract, Hydro-Québec undertook to make payment for energy whether or not taken, subject to certain limitations and compensations, and to pay CFLCo an amount equal to a portion of the interest charges on the debt incurred by CFLCo to finance the construction of the plant as well as an amount equal to a portion of the losses on foreign exchange incurred to service the debt issued in U.S. dollars. Hydro-Québec can also be required to make additional advances, against the issue of units of Subordinate Debentures and shares of Common Stock, to service the debt of CFLCo and to cover its expenses if funds are not otherwise available.

Two legal proceedings concerning the rights to the energy produced by the Churchill Falls power station are presently before the courts:

- In 1976, Hydro-Québec and CFLCo were served in an action brought by the Attorney General of Newfoundland to obtain delivery of 800,000 kilowatts of power generated from the Upper Churchill River.

Note 13
Commitments, contingencies and projected capital expenditures (cont'd)

• In 1977, Hydro-Québec began legal proceedings in Québec to obtain confirmation of its rights to the energy generated by the Churchill Falls power station.

The lower and appeal courts, both in Newfoundland and in Québec, allowed the conclusions sought by Hydro-Québec. However, in May 1986, the Supreme Court of Canada granted the Attorney General of Newfoundland leave to appeal the decision rendered by the Court of Appeal of Newfoundland, and CFLCo leave to appeal the decision handed down by the Québec Court of Appeal.

Projected capital expenditures

Hydro-Québec plans call for capital expenditures in the amount of $2,168 million for 1988.

Note 14
Reclassification

Some of the comparative figures for 1986 were reclassified in order to conform to the presentation adopted in 1987.

SUMMARY OF CONSOLIDATED OPERATIONS 1983-1987

(in millions of dollars)

	1987	1986	1985	1984	1983
Revenue					
Sales of electricity	$5,040	$4,673	$4,423	$4,101	$3,593
Other operating income	55	61	69	72	66
	5,095	4,734	4,492	4,173	3,659
Expenditure					
Operations	1,246	1,129	1,163	1,106	1,038
Electricity purchased	110	118	122	158	117
Depreciation of fixed assets	500	464	419	376	311
Taxes	289	272	246	224	209
	2,145	1,983	1,950	1,864	1,675
Income before interest and exchange loss	2,950	2,751	2,542	2,309	1,984
Interest					
Interest on debt securities	2,392	2,388	2,299	2,151	1,946
Amortization of debt-security discount and expenses	21	24	23	22	19
Net loss (net profit) on redemption of long-term debt	5	5	(10)	(18)	(18)
Interest charged to Construction in progress	(192)	(128)	(181)	(300)	(736)
Net investment income	(56)	(30)	(56)	(70)	(62)
	2,170	2,259	2,075	1,785	1,149
Exchange loss	272	189	258	223	128
	2,442	2,448	2,333	2,008	1,277
Net income	$508	$303	$209	$301	$707

CONSOLIDATED SALES AND REVENUE
1983-1987

	1987	1986	1985	1984	1983	Average annual increase (in %) 1987/ 1982
Electricity sales *(in millions of kWh)*						
Firm in Québec:						
Residential and farm	40,412	40,548	38,427	36,041	32,510	4.7
General	18,686	17,221	20,811	19,794	19,736	(0.5)
Institutional	5,255	5,014	–	–	–	–
Industrial	41,698	36,512	34,351	31,383	29,313	7.8
Other	4,362	4,241	4,052	3,804	3,582	4.4
	110,413	103,536	97,641	91,022	85,141	5.7
Surplus in Québec:						
General	1,298	1,395	1,361	928	88	–
Industrial	11,189	11,082	9,505	6,955	2,337	47.5
Neighboring systems	1,253	1,176	1,239	2,028	565	17.7
	13,740	13,653	12,105	9,911	2,990	44.8
Deliveries outside Québec:						
Firm electricity	8,313	6,980	6,898	6,299	6,702	7.6
Surplus electricity	20,456	19,954	17,295	16,583	12,835	11.0
	28,769	26,934	24,193	22,882	19,537	10.0
Total sales	**152,922**	144,123	133,939	123,815	107,668	8.1
Revenue from electricity sales *(in millions of dollars)*						
Firm in Québec:						
Residential and farm	$1,768	$1,683	$1,542	$1,422	$1,265	8.7
General	904	815	938	880	855	3.2
Institutional	223	211	–	–	–	–
Industrial	1,106	978	904	840	763	9.8
Other	182	170	157	148	137	7.5
	4,183	3,857	3,541	3,290	3,020	8.7
Surplus in Québec:						
General	15	20	24	16	1	–
Industrial	113	135	167	119	36	41.4
Neighboring systems	16	12	18	30	8	26.2
	144	167	209	165	45	41.9
Deliveries outside Québec:						
Firm electricity	256	242	218	177	171	9.3
Surplus electricity	457	407	455	469	357	8.0
	713	649	673	646	528	8.5
Total revenue	**$5,040**	$4,673	$4,423	$4,101	$3,593	9.1
Number of customer accounts *(year-end)*						
Residential and farm	2,676,810	2,599,403	2,527,643	2,445,755	2,369,163	3.2
General	226,498	219,284	235,291	230,078	255,370	(2.7)
Institutional	23,868	23,275	–	–	–	–
Industrial	13,088	13,045	13,077	12,963	12,970	2.6
Other	7,168	7,415	7,579	7,805	6,768	(1.3)
Total	**2,947,432**	2,862,422	2,783,590	2,696,601	2,644,271	2.8

ENERGY REQUIREMENTS OF SYSTEM
1983-1987

	(in millions of kilowatthours)					Average annual increase (in %) 1987/ 1982
	1987	1986	1985	1984	1983	
Total requirements						
Generated (gross)	137,730	128,078	115,538	100,343	88,321	11.8
Received:						
Purchased	30,422	30,892	32,111	36,333	31,680	(3.5)
Received as per agreement	2,118	1,940	2,368	2,210	2,484	(1.1)
	32,540	32,832	34,479	38,543	34,164	(3.4)
Total requirements	**170,270**	160,910	150,017	138,886	122,485	7.7
Québec requirements						
Firm electricity	110,413	103,536	97,641	91,022	85,141	5.7
Deliveries as per agreement	3,085	3,118	3,470	3,230	3,501	(3.1)
Total – Priority consumption	**113,498**	106,654	101,111	94,252	88,642	5.4
Generating-station service	500	514	685	652	545	8.6
Losses and other	11,122	10,655	11,928	11,188	10,767	2.3
Total priority requirements	**125,120**	117,823	113,724	106,092	99,954	5.1
Surplus electricity	13,740	13,653	12,105	9,911	2,990	44.8
Generating-station service	59*	63*	–	–	–	–
Losses and other	798*	773*	–	–	–	–
Total Québec requirements	**139,717**	132,312	125,829	116,003	102,944	7.0
Deliveries outside Québec						
Firm electricity	8,313	6,980	6,898	6,299	6,702	7.6
Surplus electricity	20,456	19,954	17,295	16,583	12,835	11.0
Deliveries as per agreement	(12)	29	(5)	1	4	–
Generating-station service	124*	127*	–	–	–	–
Losses and other	1,672*	1,508*	–	–	–	–
Total deliveries outside Québec	**30,553**	28,598	24,188	22,883	19,541	11.3
Total requirements	**170,270**	160,910	150,017	138,886	122,485	7.7

*As of January 1986, losses and generating-station service are assigned to various categories.

POWER REQUIREMENTS OF SYSTEM FOR THE WINTER BEGINNING IN DECEMBER*

	(in thousands of kilowatts)					Average annual increase (in %) 1987/ 1982
	1987	1986	1985	1984	1983	
Total requirements	**28,246**	26,004	25,745	25,487	21,961	6.9
Priority requirements	**26,005**	23,219	22,895	22,406	20,088	7.2

*The power requirements of 1987 correspond to data available at January 29, 1988. The power requirements of 1987, 1985 and 1983 include respectively 1,068 MW, 881 MW and 487 MW which were withheld through application of interruptible power clauses in certain contracts.

AUDITORS' REPORT

To the Administrators,

We have examined the statement of net assets of the Hydro-Québec Retirement Fund as at December 31, 1987 and the statement of changes in net assets for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the net assets of the Hydro-Québec Retirement Fund as at December 31, 1987, and the changes in its net assets for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Charette, Fortier, Hawey
Touche Ross

Samson Bélair

Charette, Fortier, Hawey
Touche Ross
Chartered Accountants

Samson Bélair
Chartered Accountants

Montréal, Canada
January 29, 1988

STATEMENT OF NET ASSETS

(in millions of dollars)
As at December 31

	1987	1986
Investments (Note 2)		
Bonds or debentures		
issued or guaranteed by the Government of Canada	$ 219	$ 198
issued or guaranteed by the Province de Québec	244	247
of Hydro-Québec guaranteed by the Province de Québec	481	517
issued or guaranteed by other provinces	48	52
of municipalities, school commissions, Cegeps, hospitals and universities	221	188
of corporations	234	227
	1,447	1,429
Common stock	443	259
Deep-discount investments guaranteed by the Government of Canada or by the provinces	208	210
Other investments	17	5
Cash and short-term investments	310	276
	2,425	2,179
Accrued interest on investments	42	42
Accounts receivable	5	3
	2,472	2,224
Less		
Excess special contributions made by Hydro-Québec (Note 3)	47	59
	$2,425	$2,165

Pierre Leblanc
Chairman of the
Audit Committee

Guy Coulombe
Chairman of the Board
and President and Chief
Executive Officer

Montréal, Canada
February 16, 1988

STATEMENT OF CHANGES IN NET ASSETS

	(in millions of dollars) For the year ended December 31	
	1987	1986
Balance at beginning of year	$2,165	$1,893
Increase		
Current contributions		
Employees	35	34
Hydro-Québec	70	68
	105	102
Hydro-Québec's contribution (Note 3)	16	18
Revenue from investments	219	238
	340	358
	2,505	2,251
Decrease		
Excess special contributions made by Hydro-Québec (Note 3)	5	15
Benefits paid	75	71
	80	86
Balance at end of year	$2,425	$2,165

NOTES TO FINANCIAL STATEMENTS

Note 1
Significant accounting policies

a) These statements show only the net assets of the Hydro-Québec Retirement Fund, and do not purport to show the adequacy of the Fund to meet the obligations of the Hydro-Québec Retirement Plan, which are guaranteed by Hydro-Québec.

b) Bonds, debentures and deep-discount investments are shown at amortized cost, while other investments are shown at cost.

c) Revenue from investments, contributions and benefits are accounted for on an accrual basis.

Note 2
Market value of investments

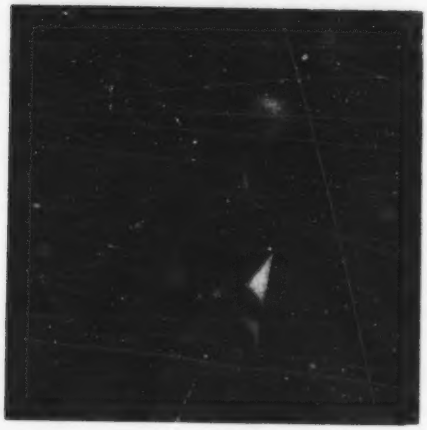
(in millions of dollars)	1987	1986
Bonds or debentures (par value of $1,446 million in 1987 and $1,420 million in 1986)	$1,441	$1,526
Common stock	446	276
Deep-discount investments	218	247
Other investments	17	5
Cash and short-term investments	310	276
	$2,432	$2,330

Note 3
Actuarial valuation

An independent actuarial valuation made in 1987 for purposes of financing the Retirement Fund showed a net surplus for the overall plan at December 31, 1986. The fund of the basic plan of the Retirement Fund showed a surplus of $250 million while the fund of the supplementary plans showed a deficit of $120 million. In conformity with the bylaws governing Hydro-Québec's retirement plan, Hydro-Québec must amortize this deficit over a maximum period of 15 years.

Previous actuarial valuations revealed excess special contributions paid by Hydro-Québec in the 1982 through 1984 financial years. These contributions and related interest are accounted for by decreasing the assets of the Retirement Fund in the item Excess special contributions made by Hydro-Québec.

Tribute To
A. Hervé Hébert



A. Hervé Hébert, Chairman of the Board of Directors, relinquished his position at the end of 1987, thus terminating a long collaboration with Hydro-Québec that began in the early 1960s when, in his capacity as an actuary, he advised the utility on the valuation of its retirement plan.

Appointed a member of the first Board of Directors in 1978, and Chairman of the Board in 1985, Mr. Hébert made a remarkable contribution to the development of Hydro-Québec. Not only did he impart his broad knowledge of Hydro-Québec's operations to his colleagues, he also gave them the sense of continuity so essential for a public utility whose actions affect the lives of all members of the community it serves.

Mr. Hébert approached his duties on the Board with a sense of discipline, a desire for specific commitment, and an independence of judgment that were of particular value in the economic and energy situation of recent years. This was a situation requiring determination and clarity of vision to reconcile complex economic choices with a management conundrum that had to deal simultaneously with the imperatives of profitability and expansion, and such societal concerns as job creation, manpower training, the place of women in the workforce, and the situation of retired personnel.

Hydro-Québec was also fortunate to benefit from Mr. Hébert's vast business background, in particular in the cooperative movement, his relations with the international financial community, and his extensive boardroom experience, which enabled him to play an important role in making Hydro-Québec more accessible to the external environment, and bringing the utility's methods and values more in line with those of the private sector at a time when the pressures of competition required greater emphasis on performance and efficiency.

On behalf of the Board of Directors, Management and Staff of Hydro-Québec, I wish to extend Mr. Hébert our heartfelt gratitude, and to assure him that we will continue to advocate within the utility the committed, disciplined and humanist approach of which he set such a fine example.

Guy Coulombe
President and Chief
Executive Officer

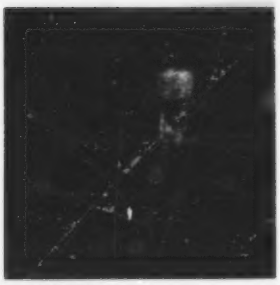
Board Of Directors
(At December 31, 1987)

Chairman

A. Hervé Hébert
President of the
Fiducie du Québec

Members

Marcel Aubut
Partner in the law firm
of Aubut, Chabot
Québec City



Michel Bélanger
Chairman of the Board and
Chief Operating Officer of the
National Bank of Canada

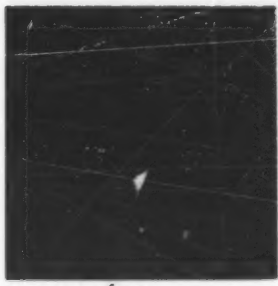
Claude Boivin
Executive Vice President,
Operations of Hydro-Québec

Guy Coulombe
President and Chief Executive
Officer of Hydro-Québec

*Jean A. D'Argensio**
Partner in the firm of
D'Argensio & Associés,
auditors

*Robert Demers**
Vice Chairman of the Board
of McNeil Mantha Inc.

Jean-Louis Dulac
President and Chief Executive
Officer of M & M
Nord Ouest Inc.

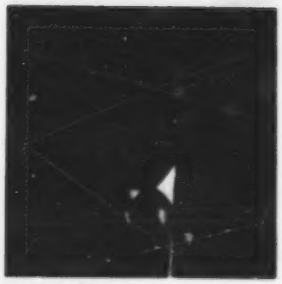


*Jean-André Élie**
Financial Adviser
with Burns Fry Ltd.

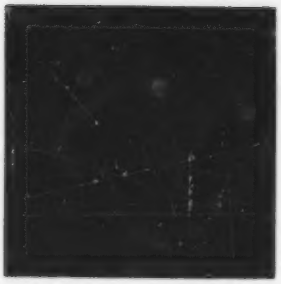
Executive Committee
of the Board of Directors

A. Hervé Hébert, Chairman
*Marcel Aubut**
Guy Coulombe
Pierre Leblanc
Claire Léger
*Michel Plessis-Bélair**

Jeannine Guillevin Wood
President and
Chief Operating Officer of
Guillevin International Inc.



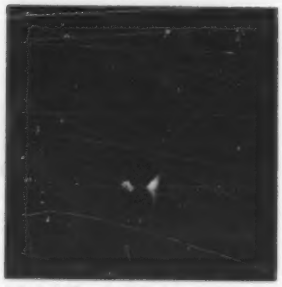
Pierre Leblanc
Partner in the firm of
Dessureault, Leblanc, Lefebvre,
chartered accountants
Trois-Rivières



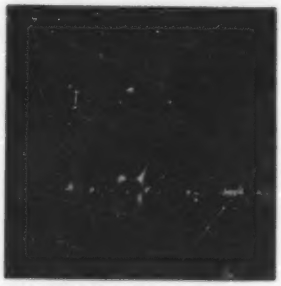
Claire Léger
Vice Chairman of
Les Rôtisseries
Saint-Hubert Ltée

*Pierre H. Lessard**
Vice Chairman of the Board
of Société Réseau
Pathonic Inc.

Denise Martin
Vice Président, Data
Processing of Les Épiciers Unis
Métro-Richelieu Inc.



*Michel Plessis-Bélair**
Senior Vice President, Finance
and Administration of Power
Corporation of Canada and
Power Financial Corporation



*Charles-Albert Poissant**
Chairman of the Board and
of the Executive Committee
of Donohue Inc.

**Appointed in 1987.*

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Executive Officer
Guy Coulombe

Executive Director
André Laporte

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General Auditor
Rollande Montsion

General Auditing I
Pierre Laurin
General Auditing II
Diane Charron

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Vice President
Lucie Bertrand*

Planning and Development
Jean-Guy Panneton

Corporate Secretariat:
General Secretary
Jean Bernier

Indian and Inuit Affairs
Robert Brunette
Law
Gilles Legault

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Executive Vice President
Jacques Guevremont

Export Sales and Marketing
Pierre Bolduc
Planning and Administration
Jean-Claude Richard
United States Affairs
Jan-G. Charuk

Finance and Administration:
Exective Vice President
John A. Hanna*

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Control
(vacant)
Administrative Services
Gilles Joyal
Budget, Financial Planning and
Management Control
(vacant)
Computer Services
Michel Taillon
Directives and Systems
Colin Longpré
Finance and Treasury
André Dubuc
Supply
Yves Gosselin

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Vice President
Jean Houde

Health and Safety
Claude Marcoux
Labor Relations
Jacques Grenier
Planning and Employee Benefits
Maurice Fortin
Remuneration, Staffing and
Development
Jean-Pierre Brassard

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Affairs:
Vice President
Marcel Couture

Internal Communications
Alain Mallette
Publications and Advertising
Roger Boisvert
Public Relations
Daniel N. Granger

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Executive Vice President
Benoît Michel*

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Claude DeGrandmont and
Yves Filion (delegates)
Environment
Daniel Dubeau
Installations Planning
André Mercier
International Affairs
Wassim Sader
Resources and Control
Philippe Biron (delegate)

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Executive Vice President
Jacques Finet*

Customer Services
Pierre Fiset
Industrial Markets
Michel Labonté
Rates Structure
Roger Lanoue

Operations:
Executive Vice President
Claude Boivin*

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Resources
Jean-Louis Comtois
La Grande Rivière Region
Pierre Nadeau
Laurentides Region
Jean-Marie Gonthier
Maisonneuve Region
André Lavoie
Manicouagan Region
Yvan Chatigny
Matapédia Region
Gérard Fournier
Mauricie Region
Joseph M. McNally
Montmorency Region
Gilles Béliveau
Richelieu Region
Gaétan Marois
Saguenay Region
Raymond Godbout
Saint-Laurent Region
Jean Bergeron (interim)

Technology, International Affairs and IREQ:
Executive Vice President
Maurice Huppé*

Research (IREQ)
Alain Brosseau
Research, Test Laboratories and System Simulation (IREQ)
Louis Masson
Technological Innovation
Toby Gilsig
Technological Planning
Denise Therrien

* Appointed in 1987.

Subsidiaries and Affiliates

Hydro-Québec has five wholly-owned active subsidiaries. The Société d'énergie de la Baie James manages Hydro-Québec's major construction projects. Hydro-Québec International provides consulting-engineering, training and management services for electric-power projects abroad. Cedars Rapids Transmission Company Limited owns and operates an electrical transmission line between Les Cèdres generating station and the Canada-U.S. border. Somarex Inc., created in 1987, will be joint owner, with Central Maine Power Company, of a new company that will design, build, finance and operate a transmission line and substation in Maine. Nouveler Inc., of which Hydro-Québec became the sole shareholder in 1987, has the new mandate to market technologies developed by Hydro-Québec.

Hydro-Québec also has a 34.2% interest in Churchill Falls (Labrador) Corporation Limited which operates the Churchill Falls power plant.

Other interests include Electrolyser Inc. (33.3%) and HydrogenAL Inc. (50%) for the production of liquid hydrogen and ArgonAL Inc. (50%) for the production of liquid argon.

Société d'énergie de la Baie James
Chairman of the Board
Benoît Michel
President and
Chief Executive Officer
(functions assumed by
Paul F. Tremblay,
Vice President and
Chief Operations Officer)

Hydro-Québec International
Chairman of the Board
Maurice Huppé
President and
Chief Executive Officer
Claude Descôteaux

Cedars Rapids Transmission Company Limited
Chairman of the Board
Pierre Bolduc
Chief Executive Officer
Jean Tremblay

Somarex Inc.
Chairman of the Board
Jacques Guevremont
President and Chief
Executive Officer
Claude Dubé

Nouveler Inc.
Chairman of the Board
Maurice Huppé
Chief Executive Officer
Claude Bolduc

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